No. 18,416

United States Court of Appeals

For the Ninth Circuit

HANS ZIMMERMAN and CLARA ZIMMERMAN,
Appellants,

vs.

UNITED STATES OF AMERICA and District Director of Internal Revenue,
Appellee.

Appeal from the United States District Court for the District of Hawaii

REPLY BRIEF FOR APPELLANTS HANS ZIMMERMAN AND CLARA ZIMMERMAN

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I

SUMMARY OF REPLY ARGUMENT

Appellee in its statement of the case has injected irrelevant and prejudicial facts not involved in this appeal and has incorrectly stated the issue involved. In its argument appellee has evaded the issues, by implication conceded the validity of appellants' position, has misstated or glossed over substantial evidence, and has attempted to justify the judgment on grounds not considered, nor required to have been considered by the trial court.

II

ARGUMENT

1. REPLY TO APPELLEE'S STATEMENT OF THE CASE. (Br. pp. 2-10.)

Appellee has in its statement of facts injected irrelevant and prejudicial material which is not involved in this appeal and has unfairly stated the question involved on appeal.

Appellee in a footnote on page 3 gives an extensive history of Dr. Zimmerman's litigation following his unjustified (II. R. 99) internment on December 7, 1941. Appellee admits in the same footnote that the facts stated are not involved in the present appeal of Count III. Particularly irrelevant and prejudicial and not a part of this record is the reference and citation of his conviction and fine for the violation of the Illinois Medical Practice Act (apparently a misdemeanor testing the constitutionality of that Act).

It is difficult to discover a legitimate purpose for this reference and therefore appellant reluctantly construes such reference as an attempt to psychologically condition this court against Dr. Zimmerman and appellants' case.

Further, on page 2, appellee states the question on appeal to be "whether the amounts *contributed* by the taxpayer to N.M.S. were deductible * * *". Appellee thus assumes as a fact the answer it desires to the ultimate issue on this appeal, namely, whether the advances made by appellants to N.M.S. *were* contributions or loans. The pre-trial order limited this issue to whether the "monies delivered" were gifts or loans. (Op. Br. p. 3.) Such subtle twisting of the

issue, whatever the motivation may be, contributes nothing to the clarification of the questions presented by the appeal.

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2. REPLY TO APPELLEE'S ARGUMENT "B". (pp. 13-22.)

Appellee has evaded and by implication conceded the substantial point argued by appellants, that a debt does not have to be payable at a specific time in order to qualify as a business bad debt. (Op. Br. p. 10.)

The opening brief presented the argument, with authorities, that the trial Court's findings and conclusions were erroneous because they were induced by and based on the erroneous view that a specific time for repayment was an essential element of a debt.

Appellee in its brief cites no cases to the contrary. In fact, appellee appears to concede that a fixed maturity date, so clearly and repeatedly emphasized by the trial Court as controlling its decision, is not a decisive element of a debt. On page 16 appellee states:

> "If a fixed maturity date was the only variation from the classic debt possibly taxpayer might still be entitled to a bad debt deduction."

The trial Court, however, emphasized that it was primarily concerned with the necessity of such a fixed maturity (II. R. 62) and hence state on II. R. 65:

> "I will say that yes, if it was a debt that it is deductible."

Such emphasis of the application of an erroneous legal standard requires reversal or remand. *Nassau v. Commissioner,* 308 Fed. 2d 39 (CA 2, 1961).

Appellee implies, however, that if a fixed maturity date is not a necessary element, it is the most important element to be considered and cites *Ludwig Bauman Co. v. Commissioner,* 312 Fed. 2d 557, 63-1 U.S. T.C. par. 9261 (1963). This case adds nothing to the law cited by appellants. There, cash advances were made by one subsidiary corporation to another and no repayments on account were made as in *Zimmerman.* The issue was not whether there was a debt or contribution but whether the advances between subsidiary corporations, not dealing at arm's length, constituted debts or equity Capital. This is clearly not the case in *Zimmerman,* where the parties were dealing at arm's length.

However, contrary to appellee's implication most cases seem to give greater weight to the expressed intention of both parties to the transaction in determining whether a debt or a gift results from an advance of money. *Nassau v. Com'r,* Supra; *Ewing v. C.I.R.,* T.C. memo, 10/4/46; *Dallas Rupe and Son v. Commissioner,* Infra.

Further, appellee in arguing that no debt existed because repayment was contingent on financial success glosses over and ignores the distinction made by the Courts between *contingent liability* and *contingent repayment.* See Opening Brief 20-21. The cases cited by appellee were either decided prior to *Dallas Rupe and Son,* 20 T.C. 363 (1953) or the facts were such that the distinction between contingencies became unnecessary.

Finally, appellee argues that there was no debt because appellants never expected repayment and so the advances were in reality contributions. (Br. p. 19.) This contention is directly contrary to the expressed expectation of payment by both Zimmerman and N.M.S. The fact that a repayment of $10,000.00 was made by N.M.S. toward reduction of the loan does not seem to impress appellee and it is glossed over as a fortuitous acquisition rather than a realization from a source of payment contemplated by the parties. (Br. p. 25.) However, the by-laws of N.M.S. (I. R. 50, art. IX) corroborates Zimmerman's testimony (II. R. 14-15) and the reasonableness of his reliance, in part, as a source of payment upon possible contributions by gift or bequest of the members of N.M.S. and others interested in the objectives of N.M.S. Bequests and devises to organizations similar to N.M.S. are not so unusual as to be completely unexpected. However, appellee's argument fails because an unqualified expectation of repayment is not an essential condition to the existence of a debt. *Drachman v. Commissioner,* 23 T.C. 558, 562; and cases cited in opening brief p. 39.

Appellee's attempt to distinguish *Dallas Rupe and Son,* Supra, the leading case in point, solely on the ground that responsible local leaders assured taxpayer there that he would be reimbursed, is indeed tenuous. (Br. p. 22.) Other members of Dr. Zimmerman's profession also assured him of repayment. It is understandable that those agents of appellee responsible for the argument might not consider members of Zim-

merman's profession *responsible local leaders.* However, Zimmerman himself had a right to assume that his professional associates were responsible and sincere in the assurances that he would be repaid. The prudence of a loan, and the reasonableness of an expectation of repayment, is to be viewed from the creditor's position when the loan is made and not the "hindsight" station of the trier of the fact. *Ewing v. C.I.R.* and other cases on p. 40 opening brief.

Candidly, on those issues relating to the existence of a debt, appellant is content to rest on the reasonableness and authority of *Dallas Rupe and Son,* which is as analogous to *Zimmerman* as it would seem reasonably possible. It has been relied upon and followed by the Internal Revenue Service. (Op. Br. p. 19.) Hence the following statement from that Court, interpolated with references to similar facts in *Zimmerman,* is presented as the best argument for appellants' position that a debt was created:

> "The fundamental question to be determined in this proceeding is whether the advances by the petitioners to the symphony were loans or contributions. The character of the petitioner's advances, whether loans or contributions, depends upon a consideration and *weighing of all the related facts and circumstances and especially the intention of the parties.* (Emphasis added.) The evidence well supports our conclusion that the advances were intended to be loans. (See I. R. 49, II. R. 28.) Petitioner's contributions to the symphony were handled differently on their books from advances. (See I. R. 55-61.) The petitioner

recorded the advances on their books as loans. (See I. R. 58-61.) Moreover, the symphony on its books recorded the advances in the same way, that is, as loans from petitioners. (See I. R. 53-4, 62-4, 67, 73.) . . . The business manager of the Dallas Symphony . . . testified as to the nature of the advances as follows:

'* * * I accepted the money and deposited it in the bank with no other thought than that it was a loan or an advance that would see us through until perhaps one of these campaigns would succeed to the point that *we would have sufficient funds that we could repay Mr. Rupe the money he had advanced and* still continue to operate.' (See II. R. 14, 17-8, 42.)

"To be distinguished is our recent case, Lucia Chase Ewing, 20 T.C. 216, involving advances of money to a ballet company. We held there that the advances did not give rise to a debt because the *obligation to repay* was subject to a contingency that did not occur. . . . The facts in the instant proceeding are different; here a *debt was owed* to petitioners by the symphony and was *definitely recognized by all the parties concerned.* (See I. R. 54, 55, 57-61, 69, 73; II. R. 45.) It was not dependent so far as being a debt was concerned upon the happening of a contingency." (Emphasis added.)

3. REPLY TO APPELLEE'S ARGUMENT "D". (pp. 26-27.)

The record amply establishes that the debt became worthless at the end of the year 1955 but in view of the Court's finding that there was no debt created it was unnecessary and would have been superfluous for the Court to have determined its worthlessness.

Appellee, on pages 11 and 26 of its brief, makes the claim that there was no evidence relating to the date of the worthlessness of the debt. The record is replete with evidence of the fact and time of worthlessness. (II. R. 118, 123, 127-130.) The following testimony of Dr. Zimmerman is illustrative:

> Q. (By Mr. Young) Why didn't you make further loans after this date?
>
> A. Well, I just felt that at that time there was no success in the future with the opposition we had that the Society would develop for the purpose for which it was organized.
>
> Q. Now, did you on that date consider that the amount which they owed you was uncollectable?
>
> A. Definitely.
>
> Q. Did you consider it in your mind a worthless debt at the close of '55?
>
> A. Definitely.
>
> Q. What reasons did you have for considering it a worthless, or uncollectable debt?
>
> A. Well, the membership dropped off considerably, and with the opposition and the interference we had with the A.M.A. in stymieing our development, I just felt it was a lost hope. (II. R. 118.)

The complaint alleged that the claim for refunds for the years prior to 1955 were made in accordance

with the provisions of Section 2511 (d) Internal Revenue Code 1954 which permitted the filing of a claim for refund for overpayment of taxes resulting from bad debts for a period of seven years from the date prescribed for the filing of the return for the year in which the loss occurred. (I. R. 5 para. g; see appendix III appellee's brief for complete statute.) Appellee has never made any contention that taxpayers were not entitled to relief afforded under this statute upon the proof of the facts alleged.

Worthlessness of a debt and the time of its worthlessness is a question of fact to be determined from the circumstances in each case. *Cammach v. United States,* 113 Fed. 2d 547 (CA 8). See also *Dallas Rupe and Son,* Supra, for a similar situation.

Since the Court found there was "no debt" because of an indefinite time for repayment, it would have been purposeless to make any finding as to when the debt became worthless. This can be done on reversal or remand. *Nassau Lens Co. v. Commissioner,* 308 Fed. 2d 39 (CA 2, 1961).

4. REPLY TO APPELLEE'S ARGUMENT "E". (pp. 27-30.)

This Court cannot under Rule 52 (a) F.R.C.P. make findings of fact and since the trial Court made no finding of fact that the debt was a non-business debt the mere conclusion of the trial Court is not sufficient.

On page 27 of its brief appellee makes the alternative argument that if this Court finds that a debt existed then it should determine that it was a non-business debt. Appellee is asking this Court to make a finding of fact not made by the trial Court. Whether a debt is a business or non-business debt is a question of fact for the trial Court alone under Rule 52 (a) Fed. R. Civ. Pro.; *Lundgren v. Freeman* (C.A. 9, 1962) 307 Fed. 2d 104. The determination of what sort of activities are within the purview of the taxpayer's business, trade or profession depends on the facts of each case. *Drown v. U.S.* (Cal. 1962) 203 F. Supp. 514. Compare, *Luther E. Smith,* 3 T.C. 696; *Murray Seasongood,* 22 T.C. 87. Both the trial Court and appellee completely gloss over the fact that *Dr. Zimmerman was also editor of the Journal of the Society* and had a profit motive in the publication of the Journal by the N.M.S. (See Op. Brief p. 42.) The lack of a finding on this issue is again explained by the conclusion of the trial Court that no debt existed, and hence any finding as to the nature of the debt would have been superfluous.

Since the trial Court made no findings of fact on this issue, this Court cannot, and the case should be reversed or remanded for this purpose. *Nassau Lens Co. v. Com'r,* Supra; *Gilbert v. Commissioner* (CA 2d, 1957), 248 Fed. 2d 399, 408.

III

CONCLUSION

The decision and judgment of the District Court were induced by and based on an erroneous view of the controlling principle of law, with the result that the Court either overlooked or intentionally disregarded all the substantial and uncontradicted evidence emanating from both the borrower, N.M.S. and the lender, appellants, that a debt and not a contribution existed as a result of advances by appellants to N.M.S.

It is respectfully submitted that the judgment should be reversed so that all the relevant, admissible evidence excluded by the trial Court can be considered on a new trial.

Dated, Honolulu, Hawaii,
April 8, 1963.

Respectfully submitted,
KENNETH E. YOUNG,
Attorney for Appellants.